

Internal Revenue Service
memorandum

CC:TL-N-5713-86

Br1:HSSchneiderman

date: JUN 24 1986

to: District Counsel, Los Angeles CC:LA

from: Director, Tax Litigation Division CC:TL

subject: Bankruptcy and TEFRA Flow-Through Cases

This is in response to your request that we post-review an advisory opinion dated May 5, 1986, that was issued to Centralized Quality Review regarding the above-captioned subject.

ISSUE

Whether the bankruptcy of a TEFRA partnership/S corporation or the bankruptcy of a partner/shareholder in such an entity precludes the Service from continuing the partnership/S corporation proceeding or issuing a notice of FPAA/FSAA. RIRA No. 6231.00-00; 9115.02-00; 9115.03-00; 9115.08-00; 9115.10-02; 9115.13-00; 9115.14-00; 9115.21-03.

CONCLUSION

The bankruptcy of a TEFRA partnership/S corporation should have no effect on the partnership/S corporation proceeding. Audits, administrative protests, Tax Court actions, settlement agreements, assessments, and collection activity may continue as if the entity had not gone into bankruptcy. On the other hand, if a partner or shareholder is named as debtor in a bankruptcy petition, the assessment or collection of tax against the bankrupt partner/shareholder is barred by the automatic stay provisions under 11 U.S.C. § 362(a)(3), (4), (5), (6). This should not adversely affect the partnership/S corporation proceeding, however, because pursuant to prop. reg. § 301.6231(c)-7, the bankruptcy of a partner converts all of the partnership items of the debtor to nonpartnership items for all years for which the Service may file a proof of claim in the bankruptcy case. Presumably, a similar rule will apply in the case of a shareholder in an S corporation. As a result, the debtor will no longer be a party to the partnership/S corporation proceeding, and thus, the proceeding may continue as if the bankruptcy had not occurred.

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DISCUSSION

Section 362 of the Bankruptcy Code provides for a broad stay of litigation, lien enforcement, and other actions, judicial or otherwise, which would effect or interfere with property of the estate, property of the debtor, or property in the custody of the estate. 11 U.S.C. § 362. As a result of the automatic stay, which becomes operative upon the filing of a petition in bankruptcy, the assessment or collection of tax and the creation or perfection of a tax lien against the debtor or the estate is prohibited. 11 U.S.C. § 362(a)(3),(4),(5),(6). However, since it is the tax liabilities of the partners or shareholders, rather than the tax liability of the partnership or S corporation, that is determined in the partnership/S corporation proceeding, the proceeding will not result in the assessment or collection of tax, or creation or perfection of a tax lien, against the partnership or S corporation. Accordingly, we agree with your conclusion that the bankruptcy of a TEFRA partnership or S corporation should not have any effect on the partnership/S corporation proceeding.

Similarly, we agree with your conclusion that notwithstanding the automatic stay, the filing of a bankruptcy petition naming a partner or shareholder as debtor should not adversely affect the partnership/S corporation proceeding. The reason for this is that pursuant to prop. reg. § 301.6231(c)-7:

The treatment of items as partnership items with respect to a partner named as debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership items as of the date the petition naming the partner as debtor is filed in bankruptcy.^{1/}

Consequently, the debtor will no longer be a party to the partnership/S corporation proceeding. Hence, the proceeding may continue as if the bankruptcy had not occurred.

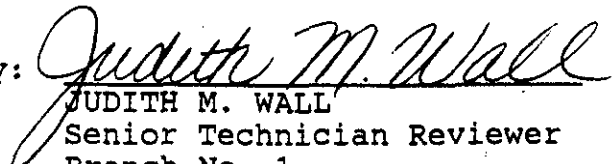
^{1/} Presumably, a similar rule will apply in the case of a shareholder in an S corporation.

Based upon the foregoing, it is the position of this office that the bankruptcy of a TEFRA partnership/S corporation or the bankruptcy of a partner/shareholder in such an entity will not preclude the Service from continuing the partnership/S corporation proceeding. Moreover, under section 362(b)(9) of the Bankruptcy Code, the Service may issue a notice of FPAA/FSAA or a statutory notice of deficiency to the debtor without violating the automatic stay. 11 U.S.C. § 362(b)(9). Therefore, in our opinion the partnership/S corporation proceeding will not be adversely affected by the bankruptcy of the partnership/S corporation or by the bankruptcy of any of the partners/shareholders.

If you have any questions concerning this matter, please contact Henry Schneiderman at FTS 566-4189.

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